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No. 169

In the Supreme Court of the United States

OCTOBER TERM, 1960

POLAROID CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the Tax Court (R. 4–16) is reported at 33 T.C. 289. The opinion of the Court of Appeals (R. 59–71) is reported at 278 F. 2d 148.

JURISDICTION

The judgment of the Court of Appeals was entered on May 3, 1960. (R. 71.) The petition for a writ of certiorari was filed on June 23, 1960, and was granted on October 10, 1960, 364 U.S. 813. (R. 72.) The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the income received during the years 1951, 1952 and 1953 by the taxpayer from sales of Polaroid

Land cameras and equipment and stereo products resulted from "discovery" within the meaning of Section 456(a)(2)(B) of the Internal Revenue Code of 1939, so as to qualify for Korean War excess profits tax relief as "abnormal income."

STATUTES AND REGULATIONS INVOLVED

Section 456 of the Internal Revenue Code of 1939 and other pertinent statutory and regulatory provisions are set forth in the Appendix to the Government's brief in the companion case, *Jarecki* v. *G. D. Searle & Co.*, No. 151.

STATEMENT

This is a proceeding involving excess profits taxes for the years 1951–1953. (R. 5, 17.) The pertinent facts, as found by the Tax Court (R. 10) and as stated by the Court of Appeals (R. 59–60), may be summarized as follows:[1]

Between 1937 and 1948, the taxpayer was engaged primarily in research and development and in manufacturing and selling a variety of optical products in the field of light polarization (such as polarizing sunglasses and visors, polarizing camera filters, polarizing day-driving visors, and variable density windows). Edwin H. Land, its president, was also its director of research. (R. 5.)

In November 1948, the taxpayer began to market (R. 7) the so-called "Polaroid Land equipment." This equipment consisted of a camera and photographic film, both invented by Land, which produced

[1] The facts were developed primarily by stipulation (R. 53–58) and a number of exhibits (unprinted) attached thereto.

a finished dry positive print directly from the camera within 60 seconds after the picture was snapped. (R. 8.)[2] Taxpayer's first patent in the "Picture in a Minute" field was issued in 1948, and numerous subsequent patents have been issued to it. (R. 8.)[3] The sales of Polaroid Land equipment resulted entirely from the equipment's capacity to produce a picture immediately. If the equipment had not made an instantaneous positive print, there would have been no demand for the camera or photographic pack. (R. 9.)

Land also had invented a synthetic light polarizer, and incorporated it in "viewers" used by audiences in viewing 3-dimensional (3–D) motion pictures. The exhibition of 3–D motion pictures (which occurred in 1952 and 1953) would not have been commercially practicable without the taxpayer's synthetic polarizer (called "stereo"), since the latter was necessary to give the 3–D illusion. The taxpayer owned three patents on this polarizer. No non-infringing material was on the market. (R. 5–6.)

During the years 1944 through 1953, the taxpayer, in the invention and development of Polaroid Land cameras and photographic packs and accessories, incurred annual expenses ranging from roughly

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[2] The Tax Court's description of the nature and novelty of Land's invention (R. 7–8) is not disputed. These details are omitted here since they do not bear on the question before the Court.

[3] At the end of 1953, 118 patents had issued on the Polaroid Land equipment and 91 additional applications were pending. At the end of 1958, 238 patents had issued and 202 additional applications were pending. In 1954, the Patent Office created a separate subclass for patent applications in the Polaroid Land equipment field. (R. 8.)

$7,000 to $388,000. (R. 9.) Its invention and developmental expenses on "stereo" ranged from $9,000 to $172,000 during the years 1943–1953. (R. 6.) During the taxable years involved, the taxpayer derived net income from its sales of Polaroid Land equipment and of "stereo" products (R. 6, 9).[4] This income is the subject of the present controversy.

Sustaining (R. 4, 10–14) the Commissioner's determination (R. 21–34), the Tax Court concluded that the taxpayer's income from the sales of Polaroid Land equipment and stereo products during the years in question was income from sales of tangible property arising out of research and development (R. 6, 9), and was not "abnormal income" under Section 456. (R. 9). It held specifically that such income did not constitute income from "exploration, discovery, or prospecting" within the meaning of Section 456(a)(2) of the Code (R. 10–14),[5] that it was not "abnormal income" within the Commissioner's Regulations thereunder (R. 14),[6] and that accordingly the taxpayer could not qualify for Korean War excess profits tax relief under Section 456.

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[4] This income, for the years 1951, 1952 and 1953, amounted to $1,229,412, $1,465,312 and $2,485,092 as to the Polaroid Land equipment, and $17,817, $2,885 and $1,592,530 as to stereo products. (R. 6, 9.)

[5] All Code references are to the Internal Revenue Code of 1939.

[6] Section 40.456–2(b) of Treasury Regulation 130, as amended by T.D. 6026 (1953–2 Cum. Bull. 285).

The Court of Appeals affirmed this holding. (R. 60–69.)[1]

ARGUMENT

This case and the companion case, *Jarecki* v. *G. D. Searle & Co.*, No. 151, involve the identical issue: Whether the taxpayer's income from sales of certain patented products resulted from "discovery" within the meaning of Section 456(a)(2)(B) of the Code, so as to qualify for Korean War excess profits tax relief as "abnormal income". In both cases, the asserted novelty of the taxpayers' products has been assumed (R. 13, 60; *G. D. Searle & Co.* v. *Jarecki*, 274 F. 2d 129, 130 (C.A. 7th)). The arguments which support the Commissioner's view—*i.e.*, that the provisions of Section 456(a)(2)(B) for excess profits tax relief as to income from "exploration, discovery or prospecting" apply only to the natural resources industries—are elaborated in our brief in *Searle* (copies of which are being served upon this petitioner) and will not be repeated here. The brief comments which follow are designed merely to pinpoint various arguments made by this taxpayer and to provide ready reference to the answering arguments developed in the Government's brief in No. 151.

1. The taxpayer asserts (Br. 23–24) that Sections 327(d) and 328 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, are the "progenitors" of Code Section 456(a)(2)(B) of the Korean War Excess Profits

[1] The Court of Appeals set aside (R. 69–71) the Tax Court's holding (R. 14–16) on a minor issue relating to the proper treatment of certain interest. The Commissioner has not sought review here as to that issue.

Tax Law. However, Section 327(d) and 328 were general provisions vesting the Commissioner with wide discretion in the administration of excess profits tax relief. See the Government's brief in *Searle* pp. 22–23 and fn. 27, p. 28. Although that statutory approach—according relief in the case of abnormalities through the exercise of broad administrative discretion—was revived, with some modifications, during the World War II period (see Sections 721(a)(2)(C) and 722 of the Code), it was purposefully abandoned in the Korean War law in favor of a system granting excess profits tax relief upon the basis of more specific criteria and in accordance with specified mathematical formulae. See the Government's brief in *Searle,* pp. 46–49, 57–60.

2. The taxpayer argues (Br. 21–24) that the court below erred in stating that the words "exploration, discovery or prospecting", appearing in Section 456(a)(2)(B) of the Korean War excess profits tax law, were derived from Section 337 of the 1918 Act (the excess profits provision limiting the rate of tax on the sale of discovered mineral property) and other provisions which have dealt, from time to time, with the natural resources industries. This argument is apparently rested on a claim that no analogous special treatment for the relief of taxpayers in the natural resources industries was accorded by successor income tax provisions. But this is not so. The grant of special income tax treatment for discovered mineral resources (whether related to annual depletion of the wasting asset or to the sale of the mineral property

itself) has had a continuous and virtually uninterrupted history (see *Searle* brief, p. 33) dating from the adoption of the 1918 Act. Thus, Section 114(b)(2) of the 1939 Code carried forward the concept of "discovery value" depletion appearing in Sections 214(a)(10) and 234(a)(9) of the 1918 Act. And Section 105 of the 1939 Code preserved the original concept of Section 211(b) of the 1918 Act, which had placed a ceiling on the rate of tax imposed upon proceeds from the sale of the mining property itself. In the interim, substantial *additional* income tax relief for the gradual sale of wasting mineral assets was provided (as an alternative to "discovery value" depletion) by the introduction and gradual expansion of the "percentage depletion" provisions (Section 204(c)(2) of the Revenue Act of 1926, c. 27, 44 Stat. 9, and Section 114(b)(3) and (4) of the Code). See also *Searle* brief, pp. 23–32, and particularly fn. 27, p. 28.

3. The taxpayer also urges (Br. 20) that the use of the phrase "research, or development of tangible property," in World War II Section 721(a)(2)(C), in association with the words "exploration, discovery, prospecting," is indicative of an intention to give broad play to the word "discovery." But, as is shown in detail in the *Searle* brief (pp. 23–28, 32–35, 50–55), the words "exploration," "discovery" and "prospecting" had acquired, long before they were used in Section 721(a)(2)(C), a limited and specific meaning in the internal revenue laws; they had reference to, and only to, natural resources (see, *e.g.*, Sections 105 and 114(b)(2) of the Code). Moreover, the argument is, in all events, self-defeating. In

Section 456(a)(2)(B) of the Korean War law, the phrase "exploration, discovery, or prospecting" stands alone—there is no mention of "research or development of tangible property"—and the omission of the latter phrase, as the congressional reports make unmistakably plain, was deliberately done for an explicit reason: Congress had concluded that to allow special treatment to income from the sale of products resulting from research and development was not feasible because it could not be restricted to "truly meritorious cases" and would make for a "loophole of major dimensions." See *Searle* brief, pp. 6–7, 12–13, 15–18, 65–67, 69–75.

4. The taxpayer's effort (Br. 27–33) to find support in the pertinent provisions[8] of the Treasury Regulations is obviously unavailing. On the face of it, those provisions are fully consistent with the terms of the statute (Section 456(a)(2)) and with the plainly expressed Congressional purpose.[9] See *Searle* brief, pp. 67–69.

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[8] Treasury Regulations 130, Section 40.456–2(b), as amended by T.D. 6026 (1953–2 Cum. Bull. 235):

"(b) * * * Income from the sale of tangible property arising out of research and development which extended over a period of more than 12 months is not included in the list of abnormal types of income to which section 456 is applicable, and such income may not constitute a class of income for purposes of that section. However, section 456 is applicable to such income if the income is otherwise property includible within a class of income to which such section is applicable, for example, the class described in section 456(a)(2)(D)."

[9] H. Rep. No. 3142, 81st Cong., 2d Sess., p. 13 (1951–1 Cum. Bull. 187, 195); and S. Rep. No. 2679, 81st Cong., 2d Sess., p. 14 (1951–1 Cum. Bull. 240, 249).

CONCLUSION

The decision of the Court of Appeals is correct and its judgment should be affirmed.

Respectfully submitted.

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